

E-cigarettes tax collection & administration:

What attributes should the tax framework for e-cigarettes have?

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Agenda

1. Introduction
2. Case studies
3. Policy recommendations

Introduction

- ▶ E-cigarettes are using battery powered electronic devices which typically heat a solution, i.e. e-cigarette liquid (hereafter: “e-liquid”), to create vapor. An electronic heating element vaporizes the liquid and the vapor condenses to form an aerosol, which is inhaled by the user. No combustion takes place, and therefore the user inhales vapor rather than smoke from the cigarettes
- ▶ Currently, there are two types of e-cigarettes that are known as open systems and closed systems
- ▶ There is a wide variety of e-cigarette products and user routines in different markets
- ▶ There is also a wide variety of excise tax administration practices in different markets

Overview of e-cigarette products

E-cigarettes

Open system

Closed system

Rechargeable reservoir to be
refilled manually

Pre-filled
cartridges

Single-use
products
(disposable)

Taxation

- ▶ Tax structure (excise tax)
- ▶ Tax base (specific/ad valorem)
- ▶ Taxation based on nicotine content

Areas that can impact Tax Collection

- ▶ Self-mixing e-liquids or dilution of nicotine liquids with nicotine-free e-liquids
- ▶ Nicotine concentration
- ▶ Self declaration
- ▶ Control mechanisms

Tax Administration

- ▶ Tax stamps/stickers
- ▶ Compliance
- ▶ License to produce and hold e-liquid products
- ▶ Excise suspension system and taxable event

Case Study – Taxation of nicotine-free liquids

Nicotine-free liquids

Overwhelming majority of countries, where e-cigarettes are excised, introduced a specific excise tax and used the volume of the e-liquid per milliliter as the excise tax base.

Many countries tax all e-cigarette liquids whether or not the liquid contains nicotine.

Russia applies taxation only e-liquids which contains nicotine of 0.1 mg/ml and above

Issues

1. While it is straightforward to measure the volume of liquid in vapor products, it is much more difficult to know how much nicotine is present in the liquid, and this requires analytical testing. Therefore, taxation based on nicotine would be extremely difficult to administer. For reference, a study of the European Commission shows that as of January 2021 there are more than 277,000 active submissions of e-cigarette products¹. Due to this high number of products, it is not practical to administer and monitor thousands of products and tax base should be easy to measure.
2. Differential excise taxation between nicotine-free and nicotine-containing e-liquid creates complexities and monitoring costs as governments are required to check exact nicotine content vs. declared content which is very complex.
3. There can be low compliance in cases of self declaration of nicotine-free liquids, e.g., in Australia, the New South Wales Department of Health said: *“in testing conducted since 2015, the Department found that 63% of e-liquids labelled as nicotine-free actually contained nicotine”*.² In Korea, the Board of Audit and Inspection randomly selected 10 e-liquid products on the market (labelled as less than 1% of nicotine extracted from tobacco stems) and it has been found that *“5 products contained more than 1% of nicotine, which is different from the value presented in the product label”*.³

Case Study – Self mixing or diluting e-liquids

Self-mixing / diluting of e-liquids

Consumers of open e-liquid systems, which are consumer modifiable and customizable, may avoid excise duties by diluting themselves e-liquids without nicotine with nicotine containing products, such as nicotine boosters or salts

In case of no excise taxation on nicotine-free e-liquids, self-mixing or diluting e-liquids would cause tax avoidance and lower compliance

Issues

1. Countries which only apply excise tax e-liquids containing nicotine may create further possibilities of excise tax avoidance by users of open tank systems if sales of pure nicotine products are not regulated. In such cases, consumers or unauthorized 3rd parties can produce their own e-liquids containing nicotine by mixing nicotine-free e-liquids with nicotine e-liquids, boosters or pure nicotine.
2. Those countries may not be able to fully collect the excise revenues anticipated from e-liquids due to low compliance levels.
3. There is an apparent possibility for excise tax evasion at a larger scale and publicly available information supports this hypothesis as open systems have higher market shares compared to closed tank systems in many countries. This impact is expected to be more relevant in countries where nicotine-free liquids are taxed less or not taxed compared to nicotine-containing e-liquids.
4. This issue should be closely monitored by regulators.

Policy recommendations

Excise tax structure and base

Specific excise taxes based on volume of all e-liquids regardless of nicotine-content can be considered as the easiest option to administer and the most efficient method to prevent potential tax loopholes and increase e-cigarette excise tax compliance.

Sealing e-liquids to prevent self mixing

Sealing liquids for e-cigarettes before sale can be considered as an effective method to prevent potential tax loopholes by self mixing and dilution.

License to produce and hold e-liquid products

Specific excise licenses for manufacturers/distributors of e-liquid products.

Producers of the taxable products should thus obtain a license from the tax authorities to produce these products legally.

Producing taxable products outside an authorized warehouse should be a criminal offence which can lead to penalties, and which also leads to a taxable event for excise duty purposes.

Tax stamps/stickers

To support better compliance with excise duty obligations and considering revenue collection deficiencies, tax stamps/stickers for e-liquids can be considered. In the EU, Estonia, Hungary, Italy, Latvia, Poland and Portugal apply tax stickers or stamps on e-liquids. Authorities can also consider more cost-efficient digital solutions to better track & trace the e-liquids.

Strict control and monitoring mechanisms

Authorities can consider to introduce measures such as random checks to monitor the declared nicotine-content of products (especially when there is a nicotine depended taxation) and to impose deterrent fines in case of no compliance between declared nicotine in the label and actual nicotine in the product.

Conclusions

Taxation of all
e-liquids with or
without nicotine

Strict control
mechanisms

Simple
administration
and high
compliance

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